KELLEY DRYE & WARREN LLP

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL ASSOCIATIONS

1200 19TH STREET, N.W.

SUITE 500

WASHINGTON, D.C. 20036

(202) 955-9600

NEW YORK, NY
LOS ANGELES, CA
MIAMI, FL
CHICAGO, IL
STAMFORD, CT
PARSIPPANY, NJ

BRUSSELS, BELGIUM
HONG KONG

AFFILIATE OFFICES
BANGKOK, THAILAND
JAKARTA, INDONESIA
MANILA, THE PHILIPPINES
MUMBAI, INDIA
TOKYO, JAPAN

FACSIMILE
(202) 955-9792

DIRECT LINE (202) 955-9888
E-MAIL: jheitmann@kelleydrye.com

ORIGINAL

EX PARTE OR LATE FILED

July 16, 1999

ORIGINAL

VIA HAND DELIVERY

Magalie R. Salas, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Notice of *Ex Parte* Presentation by Intermedia Communications Inc.

Access Charge Reform	)	**CC Docket No. 96-262**
	)	
Petition of U S West Communications, Inc. For Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	**CC Docket No. 98-157**
	)	
SBC Companies For Forbearance from Regulation as a Dominant Carrier for High Capacity Dedicated Transport Services in Specified MSAs	)	**CC Docket No. 98-227**
	)	
Petition of Bell Atlantic Telephone Companies For Forbearance from Regulation as a Dominant Carriers in Delaware; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia	)	**CC Docket No. 99-24**

RECEIVED
JUL 16 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Petition of Ameritech For Forbearance from Dominant Carrier Regulation of its Provision of High Capacity Services in the Chicago LATA	))))	**CC Docket No. 99-65**
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)))	**CC Docket No. 96-98**
Deployment of Wireline Services Offering Advanced Telecommunications Capability	))	**CC Docket No. 98-147**

Dear Ms. Salas:

Pursuant to Sections 1.1206(b)(1) and (2) of the Commission's Rules, Intermedia Communications Inc. ("Intermedia"), by its attorneys, submits this notice in the above-captioned docketed proceedings of an oral *ex parte* presentation made and written *ex parte* materials distributed on July 16, 1999 during a meeting with Commissioner Furchtgott-Roth and David Dubose, Katherine Harris, and Bill Bailey of Commissioner Furchtgott-Roth's Office. The presentation was made by Heather Burnett Gold and Julia Strow of Intermedia Communications Inc. and Jon Canis and John Heitmann of Kelley Drye & Warren LLP. Copies of the written materials distributed at the meeting are attached hereto.

During the presentation, Intermedia discussed its view that, if the Commission were to grant the ILECs special access pricing flexibility, the Commission should take coordinated action in three dockets designed to safeguard against cost-price squeezes and foster competition in the market for advanced data services.

Pursuant to the Commission's rules, Intermedia submits an original and two (2) copies of this written *ex parte* notification and attachment for inclusion in the public record of the above-referenced proceeding. Please direct any questions regarding this matter to the undersigned.

Respectfully submitted,

John J. Heitmann

John J. Heitmann

Attachments

cc: Commissioner Furchtgott-Roth
David Dubose
Katherine Harris
Bill Bailey
International Transcription Service

Intermedia Communications Inc.

Ex Parte Presentation

Additional ILEC Special Access Pricing Flexibility
CC Docket Nos. 98-11, 98-26, 98-32, 98-78, 98-91
UNE Remand
CC Docket No. 96-98
Section 706/Advanced Services
CC Docket No. 98-147

Heather Gold, *Vice President, Regulatory and External Affairs – Intermedia*
Julia Strow, *Assistant Vice President, Regulatory – Intermedia*
Jonathan Canis, John Heitmann, *Kelley Drye & Warren* LLP

July 16, 1999

Granting ILEC Requests for Special Access Pricing Flexibility Would Require Coordinated FCC Action in Three Proceedings

- Before granting ILEC requests for additional pricing flexibility for Special Access services, the Commission must consider the potential impact such action may have on the development of local competition and the deployment of advanced services.
- Thus, the Commission must take coordinated action in three proceedings:
  - ***Additional ILEC Special Access Pricing Flexibility,*** CC Docket Nos. 98-11, 98-26, 98-32, 98-78, 98-91
  - ***UNE Remand,*** CC Docket No. 96-98
  - ***Section 706/Advanced Services,*** CC Docket No. 98-147
- The coordinated FCC actions proposed herein are necessary to prevent unreasonable discrimination against CLECs and to eliminate the potential for anticompetitive price squeezes.

DC01/HEITJ/86913.1

The Danger of Special Access Pricing Flex

- Any grant of Special Access pricing flexibility must be accompanied by measures designed to mitigate the potential for "price squeezes" and other predatory pricing activity by ILECs.
  - Grant of the ILECs' requests for flexibility to offer Special Access services to end users at average variable cost ("AVC") effectively would sanction a classic cost-price squeeze harmful to Intermedia and other facilities-based CLECs whose analogous network component inputs are UNEs priced at TELRIC.
  - Because AVC does not include all of the cost components of TELRIC rates, such as depreciation, joint and common costs, and reasonable profit, *AVC costs will always be lower than TELRIC costs.*
- Given these facts, the Commission could decline to grant additional pricing flexibility, set a Special Access pricing floor above TELRIC, or it can adopt a package of safeguards proposed herein by Intermedia.

Special Access Pricing Safeguards

- Rather than require extensive cost analyses or invite parties to initiate rate complaints, the FCC should instead require:
  - full disclosure of Special Access CSAs, term and volume discount plans, and similar "individual case basis" offerings through publication
  - permit resale of such arrangements, pursuant to the avoided cost standard of section 251(c)(4).
    - Similar to AT&T Tariff No. 12, ILECs would not have to identify customers, but they would have to identify all types of services being offered, and the rates for each type of service. Unregulated services or functions must be priced separately -- the bundling of unregulated services in a CSA should in no way foreclose a CLEC from reselling a CSA.
    - To guard against discriminatory "sweetheart" deals, the Commission should limit maximum volume discounts to traffic generated within a state.
- By taking such action, the FCC could curtail the potential for protracted rate litigation by effectively allowing the industry to police itself. ILECs will not price at predatory levels if Special Access CSAs are subject to resale.

Coordinated Action in the UNE Remand and Advanced Services Proceedings

- To complement the Special Access safeguards set forth above, the FCC should take the following actions in the UNE Remand and Section 706/Advanced Services proceedings. These actions are necessary to ensure facilities/UNE-based competition in all market segments, including advanced services.

  UNE Remand

  - Require extended link combinations and define frame relay UNEs, including FRALs, NNI ports, UNI ports, and DLCIs @ CIR.
  - Require volume and term discounts for UNEs.

  Section 706/Advanced Services

  - Clarify CLECs' rights to Section 251(c)(2) interconnection at Section 252(d)(1) pricing for frame relay and other advanced services.
  - Establish resale discounts for advanced services.

INTERMEDIA COMMUNICATIONS INC.
POSITION PAPER ON ADDITIONAL ILEC PRICING FLEXIBILITY

JULY 14, 1999

I. Summary

Any initiative to provide incumbent local exchange carriers ("ILECs") additional pricing flexibility for Special Access service pricing must consider the potential impact of such pricing flexibility on the development of local competition. As described in this position paper, any expanded pricing flexibility adopted by the Commission must guard against unreasonable discrimination against CLECs.

To prevent discrimination, the Commission should be aware that ILECs could use pricing flexibility as a tool to work a "price squeeze" against CLECs. Pricing flexibility could result in a situation where ILECs are able to offer Special Access service arrangements to end users at average variable cost ("AVC") while CLECs are required to purchase analogous facilities at total element long run incremental cost ("TELRIC"). Because AVC does not include all of the cost components of TELRIC rates, such as depreciation, joint and common costs, and reasonable profit, AVC costs <u>will always be lower</u> than TELRIC costs. This pricing differential will result in a classic price squeeze unless the Commission takes action to mitigate potential predatory pricing. To protect against such a price squeeze, the Commission should require ILECs to publish and make available at resale rates all contract service arrangements ("CSAs"), volume discount plans, and similar "individual case" offerings.

II. Any Pricing Flexibility Rules Adopted by the Commission Must Prevent Unreasonable Discrimination

Despite the availability of unbundled network elements ("UNEs") and collocation, most CLECs still rely on Special Access to serve their customers for a variety of operational reasons. For example, ILECs provide shorter provisioning intervals and higher service quality for Special Access than for UNEs. ILECs typically provision DS1 Special Access in three-to-five days, whereas DS1 UNE loops often take six weeks to provision. As for service quality issues, ILECs provide CLECs with service quality guarantees under Special Access arrangements, but do not do so for UNEs. In addition, ILECs install Special Access for CLECs without disruption to end-user customers. With UNEs, customers always experience loss of service. Moreover, in cases where collocation is required, even under the FCC's new collocation rules, it can take 10 weeks or more before a CLEC is able to order a DS1 UNE.[1]

These service considerations mean that CLECs can't rely on UNEs due to delays and disruption, particularly in a competitive market situation. ILECs have continuously

[1] *See, e.g.*, New York Telephone Company, Tariff P.S.C. 914 – Telephone, § 5.1.4(D) (indicating a 76 day interval for physical collocation) (attached hereto as Tab A).

sabotaged collocation and UNE processes to deny their effective use by CLECs, forcing CLECs to rely on Special Access rather than UNEs. Permitting such a result to continue would allow the ILECs to foreclose CLEC entry into local markets through one of the three pathways envisioned by Congress – UNEs.

III. Any Grant of ILEC Customer-Specific Pricing Authority Must Be Accompanied by Standards that Prevent ILECs' Ability to Establish a Price Squeeze

Setting a price floor for ILEC retail and wholesale services at AVC will create a price squeeze against facilities-based CLECs that purchase UNEs. As a general matter, AVC is thought to be the minimum price needed for the recovery of costs necessary to produce goods. Pricing below AVC would indicate that a company is charging less for a finished good or service than the average cost of the inputs used to produce the good or service, which strongly suggests predatory pricing. The Supreme Court has defined predatory pricing as either "(i) pricing below the level necessary to sell … products, or (ii) pricing below some appropriate measure of cost."[2] With regard to properly measuring cost, the Sixth Circuit has found that pricing below marginal cost or AVC is presumptively illegal, and pricing above marginal cost or AVC is presumptively legal.[3] Indeed, for the last decade, the FCC has used AVC to set price floors for ILEC wholesale and retail services.[4]

While AVC covers only the average variable costs associated with producing a good or service, the Commission's TELRIC standard – the pricing standard for UNE rates – includes additional costs, including joint and common costs, depreciation, and a reasonable profit.[5] As such, TELRIC rates always will be higher than AVC rates. Permitting ILECs to set Special Access rates at AVC would undercut TELRIC-based UNE rates, which would essentially codify a classic "price squeeze" against CLECs seeking to enter local markets using "cost-based" UNEs made available under the Act's unbundling provision, section 251(c)(3).

---

2 *Cargill Inc. v. Monfort of Colorado*, 107 S.Ct. 484, 493 n.12 (1986) (attached hereto as Tab B).

3 *Arthur S. Langederfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050, 1056-57 (1984) (attached hereto as Tab C).

4 *See Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3114-15 (1989) (adopting AVC as a pricing floor) (attached hereto as Tab D). *See also*, *GTE Telephone Operating Companies Investigation of Below-band Transport Rates*, 10 FCC Rcd 1573, 1574-75 (1994) (placing "great weight" on whether GTE's tariff rate covers AVC to "check against predation," and noting that variable costs should include "all access charges and billing and collection costs attributable to the service, as well as other non-fixed costs which would not be incurred if the service were not offered") (citation omitted) (attached hereto as Tab E).

5 *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Memorandum Opinion and Order, 11 FCC Rcd 15499, 15850-56 (1996) ("*Local Competition Order*") (attached hereto as Tab F).

A price squeeze already is occurring for advanced services. For example, U S WEST currently offers "DS1 Capable Loop" UNEs at $90.50 per month.[6] Because U S WEST's loops are bottleneck facilities, competitors must purchase these loops in order to compete with U S WEST's advanced service offerings. Yet U S WEST's tariffed ADSL services are priced at:

- $57.20 - $65.00 for 512 Kbps service,
- $70.40 - $80.00 for 768 Kbps service, &
- $110.00 - $125.00 for 1 Mbps service.[7]

For the higher capacity service, the cost of the loop alone exceeds the price of the services against which CLECs must compete. When the additional TELRIC costs of collocation and cross-connects are included, there can be no question that the TELRIC costs of essential components are higher than U S WEST's current rates for services against which CLECs will compete.

This price squeeze issue has been pending before the Commission at least since the initiation of the section 706 rulemaking proceeding in CC Docket No. 98-147. In that proceeding, for example, NorthPoint Communications described the price squeeze at issue as follows:

> A price squeeze exists whenever a competitor that is equally efficient at providing the competitive portions of a service cannot, without losing money, meet the incumbent's retail price given the price(s) that it must pay to the incumbent for any bottleneck input(s) available only from the incumbent. A price squeeze can be the result of the markup over direct economic cost [*i.e.*, marginal cost or AVC] that the incumbent imposes for bottleneck inputs that both it and the competitor use or the incumbent's imposition of costs on the competitor that the incumbent does not bear at all. To avoid a price squeeze, the incumbent's retail price must equal or exceed the sum of the price that it charges to competitors for the bottleneck input(s) plus the total service long-run incremental cost of the competitively provided portions of the service.[8]

The existence of AVC pricing for Special Access and TELRIC pricing for UNEs would sanction an ILEC price squeeze on competitors. As discussed below, permitting resale of Special Access, including Special Access CSAs, would be the surest way to thwart any potential predatory price squeeze without entangling the Commission in on-going complaint proceedings regarding the reasonableness of ILEC rates.

---

6 U S WEST written *ex parte* in CC Docket No. 98-157 & 99-1 (Apr. 8, 1999) (attached hereto as Tab G).

7 U S WEST, Tariff F.C.C. No. 5, § 8.4.3 page 8-114 (attached hereto as Tab H).

8 CC Docket No. 98-147, Comments of NorthPoint Communications, Inc. at 36 (Sept. 25, 1999) (attached hereto as Tab I).

IV. Public Disclosure of Customer-Specific Rates and Full Implementation of the Resale Provisions of the Communications Act Are Essential to Prevent Anticompetitive Abuse of Customer-Specific Pricing Authority

The existence of different pricing standards for Special Access and UNEs raises considerable problems. But rather than require extensive cost analyses or invite parties to initiate rate complaints that could embroil the FCC, it should instead require full disclosure of Special Access CSAs through publication and permit resale of such arrangements, pursuant to the avoided cost standard of section 251(c)(4). By taking such action, the FCC would effectively allow the industry to police itself, as ILECs will not price at predatory levels if Special Access CSAs are subject to resale.

A. All customer-specific rates must be published

To ensure compliance with any FCC-set cost floors and resale requirements, ILECs must be required to publish the general terms and conditions of Special Access CSAs. At a minimum, this would require ILECs to post rates on their websites, consistent with the FCC's recent truth in billing rules. Similar to AT&T Tariff No. 12, ILECs would not have to identify customers, but they would have to identify all types of services being offered, and the rates for each type of service. Critical items that ILECs must make available in any posted CSA include: (1) types of services, (2) volume commitments, (3) term, (4) quality of service guarantees, and (5) geographic area covered, including any rate zones. Unregulated services or functions may be included; however, these items must be priced separately, and the bundling of unregulated services in a CSA should in no way foreclose a CLEC from reselling a CSA.

B. Wholesale services must be available to CLECs for resale

In addition to requiring publication, CSAs and other Special Access wholesale offerings must be available for resale. Intermedia understands that the Commission up to this point has not required ILECs to resell exchange access services because the "vast majority" of purchasers of interstate access service are telecommunications providers, who are not permitted to purchase for their own use ILEC wholesale services.[9] However, the Commission did note that "end users do occasionally purchase some access services,"[10] and for these end users, the Commission should permit competitive carriers to purchase exchange access services at wholesale rates for resale. Moreover, in its section 706 Notice of Proposed Rulemaking, the Commission tentatively concluded that ILEC advanced services – which are interstate access services – should be made available to competitors at wholesale rates pursuant to the resale provision of the Act.[11] To limit the possibility of the price squeeze described above, the Commission should extend this analysis to all Special Access services – including CSAs and

---

9 *Local Competition Order*, 11 FCC Rcd at 15934-5, ¶ 873 (attached hereto as Tab J).

10 *Id.*

11 *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, FCC 98-188, (Memorandum Opinion & Order and Notice of Proposed Rulemaking), (rel. Aug. 7, 1998), ¶¶ 188-89 (attached hereto as Tab K).

volume discount plans – and require resale pursuant to the avoided cost standard of section 251(c)(4).[12] Doing so is fully consistent with the Communications Act, and would encourage the industry to police itself, rather than engage in protracted rate litigation.

As noted in the Commission's rules, resale restrictions are presumed unreasonable unless an ILEC "proves to the state commission that the restriction is reasonable and nondiscriminatory."[13] Indeed, the Commission rejected two BellSouth applications for section 271 relief in part because failure to offer CSAs at a state commission-approved wholesale rate violates the section 271 competitive checklist.[14] Not until BellSouth modified its Louisiana statement of generally available terms and conditions to apply the state wholesale discount rate to CSAs did the Commission find that BellSouth had satisfied its obligation to resell services at state commission-set rates.[15]

In the *Local Competition Order*, the Commission specifically considered and rejected ILEC claims that CSAs and volume offerings should be excluded from resale.[16] As the Commission noted, "[i]f a service is sold to end users, it is a retail service, even if it is priced as a volume-based discount off the price of another retail service."[17] In addition, in the *BellSouth South Carolina Order*, the Commission expressly rejected BellSouth's argument that application of the state commission-set wholesale discount to CSAs would overstate the costs avoided because ordinary marketing costs are not incurred for individually negotiated arrangements.[18] In fact, Intermedia submits that the avoided cost of ILEC CSA arrangements would actually be greater than that of standard offerings because CSAs require ILECs to develop business cases to ensure that customers qualify for a CSA and to implement special billing arrangements unique to the CSA customer.

12 *See, e.g.*, CC Docket 98-147, Comments of Intermedia Communications Inc. at 60 (attached hereto as Tab L).

13 47 C.F.R. § 51.613(b) (attached hereto as Tab M).

14 *See Application of BellSouth, et al. Pursuant to Section 271 of the Communications Act of 1934, as Amended to Provide In-Region, InterLATA Services in South Carolina*, 13 FCC Rcd 539, 657-63 (1997) ("*BellSouth-South Carolina Order*") (attached hereto as Tab N); *see also Application of BellSouth, et al. Pursuant to Section 271 of the Communications Act of 1934, as Amended to Provide In-Region, InterLATA Services in Louisiana*, 13 FCC Rcd 6245, 6281-88 (1997) (attached hereto as Tab O).

15 *See Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Louisiana*, FCC 98-271, (Memorandum Opinion and Order), rel. Oct. 13, 1998), ¶¶ 310-11 (attached hereto as Tab P).

16 *Local Competition Order*, 11 FCC Rcd at 15971 (attached hereto as Tab Q).

17 *Id.*

18 *BellSouth-South Carolina Order*, 13 FCC Rcd at 661-62 (attached hereto as Tab R).

C. Volume and term discounts must be made available to carriers on a nondiscriminatory basis

Unless volume and term discounts are made available to all competitors on a nondiscriminatory basis, mega-carriers will have the ability to enter "sweetheart" deals with one another that only they can generate. Such a result would be discriminatory by freezing out smaller carriers, including regional carriers.

Failure to make volume and term discount plans available on a nondiscriminatory basis would be bad telecom policy because it would encourage the biggest carriers to consolidate in favorable arrangements. In addition, such a failure would be bad economic policy, as it assumes cost economies are in a straight linear relationship that never caps out or otherwise experiences "diminishing returns." To correct these potential problems, the Commission should limit maximum volume discounts to traffic generated within a state. Doing so would permit ILECs to reflect legitimate volume cost savings in their rates and keep volume discounts open to a wide array of small and regional carriers – typical CLECs may not be able to match volumes nationwide or within an ILEC region, but may be able to match volumes of the largest carriers in a given state. Constraining volume discounts to the state level also is consistent with the volume and term discount schedules currently tariffed by most ILECs, which are made on a state by state basis.